The Washington Post

Business

As Dow climbs past 20,000, is this the bubble Trump called?

By Thomas Heath January 25

The Dow Jones industrial average blew past the 20,000 threshold for the first time in trading Wednesday, propelled by President Trump's calls for massive infrastructure spending, lower corporate taxes and regulatory rollbacks and the pro-business theme defining his first days in office.

U.S. markets advanced across the board Wednesday. The closely watched Standard & Poor's 500-stock index and tech-heavy Nasdaq were up less than 1 percent. And as the Dow closed at 20,068, it notched the second-fastest thousand-point gain since the dot-com bubble of 1999.

The run-up in stock prices has added about $2 trillion in market value since the presidential election to companies that make up another broad index, the Wilshire 5000. Their fast rise is ironic given Trump's proclamation last summer that stocks were in a bubble due to the Federal Reserve's policies, which has kept its benchmark interest rate near zero for years.

"If rates go up, you're going to see something that's not pretty," Trump told Fox News last August in a phone interview. "It's all a big bubble."

In a September presidential debate, Trump reiterated: "We are in a big, fat, ugly bubble."

As president, Barack Obama presided over an economy buoyed by record-low interest rates instituted after the 2008-2009 financial crisis.

The Fed's policies helped push the stock market to record gains, with the S&P 500, for instance, barreling up 301 percent by Wednesday from its closing low of 666 on March 6, 2009. Easy money lubricated the economy and pulled down unemployment while pumping up stock and real estate prices.

Analysts, bankers and financial managers said Wednesday that Trump's early steps in office may provide additional underpinning to lofty stock prices.

“Investors hope that there are distinct differences between candidate Trump and President Trump,” said Marvin McIntyre, a managing director in Morgan Stanley’s wealth management group. “It’s logical to assume that his previous assertion that the market was in a bubble is no longer applicable. The promise of lowering both corporate and individual taxes, reducing or eliminating burdensome regulations, and massive infrastructure spending is positive for the market.”

Former U.S. senator Peter Fitzgerald, a lifelong banker and founder of Chain Bridge Bank in McLean, cautioned that stock prices are near all-time highs based on their earnings. The rally, bubble or whatever name one attaches to the current surge could deflate rapidly if the Fed raises rates.

Interest rates are like gravity to stock and real estate values, Fitzgerald said. As rates rise, stock and real estate prices usually deflate.

“The challenge is going to be the Fed,” said Fitzgerald, a Republican and Trump supporter. “The Fed has recently embarked on a tightening campaign and is now removing liquidity. The Fed has tightened 13 times since World War II, and only three of those times did we get a soft landing.”

The tricky balance going forward will be to keep stock prices from tanking while at the same time encouraging the Fed to maintain realistic interest rates that could keep inflation in check and avoid a bubble. Analysts say the Fed could send the economy into recession if it raises rates multiple times this year.

Trump’s initial steps have had some effect of reassuring markets after years of pent-up anxiety about Obama’s support for regulation, analysts said.

“It’s the return of animal spirits,” said John Canally, chief economic strategist for LPL Financial, with $502 billion under management. “Markets don’t like regulations, and Mr. Trump said he is reducing regulations. And that is helping.”

Canally cautioned that less than a week into the new administration, most details of its policies are unclear, and some could blow out the federal deficit and kill the stock market rally.

Canally said stocks are ahead of themselves and predicted that the S&P 500 will earn slightly below-average returns over the next decade. That would put annual returns in the 6 percent range, he said.

“We are less than a week in. A lot of policy has to be written and implemented,” Canally said. “The market is giving Trump some credit for this. But some is going to the prior administration as well. It’s too soon to give Trump all the credit.”

Greg McBride, chief financial analyst with Bankrate.com, a personal finance website, said the post-election “Trump rally” is “based on this notion of less regulation, more infrastructure spending, tax cuts and a generally favorable environment toward business.”

Markets responded after Trump issued Tuesday executive actions advancing the construction of the $8 billion Keystone XL pipeline and the proposed $3.7 billion Dakota Access pipeline. The pipelines would carry crude oil hundreds of miles across the Great Plains states. In the face of protests from environmental advocates and Native American groups, the Obama administration had opposed both projects.

The 120-year-old Dow, with its 30 blue-chip stocks, is a key metric for U.S. companies. The Dow is up more than 9 percent since Trump's surprise election victory in November.

Wall Streeters cautioned that the Dow milestone was fun to watch and good for shareholders but was not of any particular value. The S&P 500 and Nasdaq closed at record highs Tuesday — to little fanfare.

"The Dow hit 20,000. The Queen of England turned 90 last year," McBride said. "Both are round numbers. Neither carry any real significance."

Thomas Heath is a local business reporter and columnist, writing about entrepreneurs and various companies big and small in the Washington Metropolitan area. Previously, he wrote about the business of sports for The Post's sports section for most of a decade. Follow @addedvalueth